

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE BUFFALO CITY METROPOLITAN ECONOMIC ENTITY**

## **REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the consolidated financial statements of the Buffalo City Metropolitan Economic Entity set out on pages ... to ..., which comprise the consolidated statement of financial position as at 30 June 2014, the consolidated statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the consolidated financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2013 (Act No. 2 of 2013) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for qualified opinion**

#### **Irregular expenditure**

6. Irregular expenditure disclosed in note 55 to the consolidated financial statements at R747 million (2013: R931 million) was understated. This is as a result of the municipality not having adequate systems in place to identify and disclose all irregular expenditure incurred during the current and previous financial periods as required by section 125(2)(d)(i) of the MFMA. Due to these inadequate systems it was impracticable to

determine the full extent of the understatement. Accordingly, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

#### **Qualified opinion**

7. In my opinion, except for the effects and possible effects of the matter described in the basis for qualified opinion paragraph, the consolidated financial statements present fairly in all material respects the financial position of the Buffalo City Metropolitan Economic Entity as at 30 June 2014 and financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP, and the requirements of the MFMA and DoRA.

#### **Emphasis of matter**

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Significant uncertainty**

9. The municipality entity is a defendant in a number of lawsuits to the amount of R166 million (2013: R218 million) as disclosed in note 61 to the consolidated financial statements. The outcome of these lawsuits cannot be determined at present as litigation is still in progress.

#### **Restatement of corresponding figures**

10. As disclosed in note 49 to the consolidated financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during the year ended 30 June 2014.

#### **Impairments**

11. Cumulative provisions for impairments of R456 million (2013: 376 million) relating to receivables from exchange transactions and R230 million (2013: R189 million) relating to receivables from non-exchange transactions are disclosed in note 7 and 8 respectively.
12. As disclosed in the consolidated statement of financial performance and note 36 to the consolidated financial statements, debt impairments totalling R241 million (2013: R107 million) have been expensed.

#### **Material losses**

13. The municipality incurred material losses as disclosed in note 57 to the consolidated financial statements. These include the following:
  - Electricity losses totalling R118 million (2013: R85 million) of which non-technical losses comprise R71 million (2013: R41 million).
  - Water losses totalling R99 million (2013: R103 million) of which non-technical losses comprise R9 million (2013: R10 million).

#### **Additional matter**

14. I draw attention to the matter below. My opinion is not modified in respect of matter.

#### **Unaudited disclosure notes**

15. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the consolidated financial statements and accordingly I do not express an opinion thereon.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

16. In accordance with the PAA and the general notice issued in terms thereof, I report the

following findings on the reported performance information against predetermined objectives for the selected development priorities presented in the annual report, compliance with legislation as well as internal control. I performed tests to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2014.
  - Development priority 1: Water services
  - Development priority 4: Roads and storm water
  - Development priority 7: Solid waste management
  - Development priority 8: Housing
  - Development priority 9: Sanitation
  - Development priority 13: Electricity
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPi).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. I did not raise any material findings on the usefulness and reliability of the reported performance information for the following selected priorities:
  - Development priority 1: Water services
  - Development priority 4: Roads and storm water
  - Development priority 8: Housing
  - Development priority 9: Sanitation
  - Development priority 13: Electricity
22. The material findings in respect of the development priority 7: Solid waste management are as follows:

### **Development priority 7: Solid waste management**

#### **Usefulness of reported performance information**

#### **Performance targets not specific and indicators not well defined**

23. The FMPPi requires that performance targets must be specific in clearly identifying the nature and required level of performance and also requires performance indicators to be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 60% of the targets were not specific and a total of 20% of the indicators were not well defined. This was due to a lack of understanding of the performance management system by the municipal officials. In addition, reviews of the service delivery and budget implementation plan within the municipality to ensure that planned indicators and target are specific and well defined were inadequate.

### **Reliability of reported performance information**

24. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This is a result of limitations that were placed on the scope of my work as the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

### **Additional matters**

25. I draw attention to the following matters:

#### **Achievement of planned targets**

26. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings expressed on usefulness and reliability of the reported performance information as reported above.

#### **Adjustment of material misstatements**

27. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for developments priorities relating to water services and electricity. As management subsequently corrected the misstatements, I did not raise material findings on the usefulness and reliability of the reported performance information that was corrected.

#### **Unaudited supplementary information**

28. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited this information and, accordingly, I do not report thereon.

### **Compliance with legislation**

29. I performed procedures to obtain evidence that the municipality had complied with the applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows

#### **Annual financial statements**

30. The consolidated financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, revenue and disclosure items identified by the auditors in the submitted consolidated financial statements were subsequently corrected, but the uncorrected material misstatement resulted in the consolidated financial statements receiving a qualified audit opinion.

#### **Asset management**

31. Asset management was inadequate as a perpetual asset register was not in place. The accounting and information systems did not support internal controls for assets as required by section 63(2)(a) and (c) of the MFMA.

#### **Consequence management**

32. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not always investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
33. Council certified irregular expenditure as irrecoverable without having conducted an

investigation into every award made, as required by section 32(2)(a)(ii) of MFMA. The consolidated financial statements are not materially misstated as management had written back the items that were not subject to investigation.

#### **Expenditure management**

34. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
35. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.

#### **Procurement and contract management**

36. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by obtaining the required price quotations, as required by supply chain management (SCM) regulation 17(a) and (c).
37. Sufficient appropriate audit evidence could not be obtained to verify that construction projects were registered within 21 days with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
38. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
39. Related party non-compliance was identified in the following instances:
  - For prior period awards identified through the audit no effective steps were taken to prevent or combat the abuse of the SCM processes in accordance with SCM regulation 38(1) in respect of the following:
    - Awards were made to providers whose directors or members are in the service of the municipality.
    - Awards were made to providers who are in the service of other state institutions or whose directors or members are in the service of other state institutions, both of which are in contravention of section 112(j) of the MFMA and SCM regulation 44.
  - Persons in the service of the municipality or close family members who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) issued in terms of the Municipal Systems Act (MSA).
  - Contracts and quotations were awarded to bidders who had not submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

#### **Strategic planning and performance monitoring**

40. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46 (1)(a-c) of the MSA.
41. Measurable performance targets for the financial year with regard to one of the six development priorities and key performance indicators were not set in the integrated development plan (IDP), as required by section 41(1)(b) of the MSA and regulation 12(1) and 12(2)(e) the *Municipal planning and performance management regulations* (MPPMR).
42. The performance management system and its related controls were inadequate as it did not describe and represent the processes of performance (planning, monitoring, measurement, review, reporting and improvement) and how they are conducted,

organised and managed, as required by sections 38 of the MSA and regulation 7 of the MPPMR.

### **Internal control**

43. I considered internal control relevant to my audit of the consolidated financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion and the findings on the annual performance report and compliance with legislation included in this report.

### **Leadership**

44. Leadership have not instituted all the disciplines necessary to enable oversight and monitoring that promote efficiency and effectiveness in financial management, service delivery reporting and compliance with laws and regulations. This did not set the correct tone in building a high performance environment that promotes accountability.
45. The leadership did not implement effective human resource management to ensure that adequately and sufficiently skilled resources are in place as a number of key positions within top and middle management were vacant for extended periods of time. The continued absence of permanent officials to lead and guide the municipality compromised the effectiveness and stability of the control environment. As a result performance management is not adequately implemented and monitored and, where necessary, consequence management is not always applied.
46. There was a lack of integration and alignment within the municipality, as the different directorates planned, worked and reported in isolation. This had a negative impact on the performance of the municipality and its ability to prepare consolidated financial statements and an annual performance report that were free of misstatements.
47. Leadership has not sufficiently addressed the previously reported challenges faced by the municipality's SCM unit. This was largely as a result of inadequate capacity within the SCM unit which resulted in poor record keeping and monitoring throughout the year. This was further aggravated by poor planning, implementation and monitoring of contracts by user directorates within the municipality.

### **Financial and performance management**

48. The municipality did not fully implement and monitor all required daily and monthly financial, performance and compliance disciplines to verify the credibility of in-year reporting. This resulted in key reconciliations and processing only being performed after the financial year-end. This could impact the sustainability of the reported opinion if not appropriately addressed by the municipality.
49. The municipality did not implement an effective performance management system that enables leadership to hold all officials accountable for the work they perform on a daily basis.
50. There was a lack of processes in place to ensure compliance with laws and regulations. As a result, management did not effectively monitor and address areas of non-compliance.

### **Governance**

51. A risk assessment was conducted by the municipality; however, risks identified within this assessment were not appropriately mitigated within the control environment. The effectiveness of the fraud hotline was delayed as it only became operational in the last quarter of the financial year.
52. The internal control deficiencies identified by internal audit and recommendations made by both internal audit and the audit committee were not adequately addressed by

management. This had an impact on the effectiveness of these parties in providing assurance on credible financial and performance reporting as well as compliance with applicable laws and regulations.

### Investigation

53. The member of the executive council for Local Government and Traditional Affairs and the Directorate for Priority Crime Investigation are investigating allegations of irregularities with respect to the state funeral procurement. This investigation was pending at year-end.

*Auditor-General*

East London

8 December 2014



AUDITOR-GENERAL  
SOUTH AFRICA

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